

Tobacco Tax Enforcement Issues

Senator Roger Kahn February 2012

1 In 2005 California announced \$125M in increased tobacco product tax collection and stated that the new digital cigarette tax indicia was a large part of their success. Before they had used (like Michigan) a heat-transfer cigarette tax stamp. They were losing nearly \$300M a year due to tax evasion (counterfeit stamps, smuggling etc).

2. As of 2011 according to the California Board of Equalization their success in combatting evasion continues and generates \$133M that year that would otherwise have been lost due to illegal activity.

3 Congress is looking at this too: Sen. Lautenberg (NJ) and Rep Doggett (Tx) and have drafted the STOP act (Smuggled Tobacco Prevention). So far it has failed to get to the floor in Congress.

4. Michigan revenue loss compares to California as we are a high tax and therefore a high tax evasion state (GAO March 2011 study). We also use the heat-transfer stamp. Our heat transfer stamp source is discontinuing production and we must find a replacement. Our costs for stamps will be increasing.

It should be noted that we lose more than tobacco tax revenue. Losses include sales tax revenue and Master Settlement Agreement Manufacturers Holdback dollars. In the latter case this totaled \$160M between 2006 and 2011 alone. This is being litigated by the AG and big tobacco and is also being arbitrated and is a year by year expensive undertaking. We are currently arbitrating 2003! The issue is Michigan's lack of *diligent enforcement* of the MSA. The size of state liability could be much higher (\$3B) if it is found we did not enforce our model agreement.

I have been told that we are losing \$50-100M yearly that we could recover by switching to digital tax indicia as part of an enhanced enforcement program. Additionally, better enforcement will protect Michigan's legitimate wholesalers and retailers who can't compete against illegal schemes.

5. We appropriated 3M to treasury to cover the costs of enhanced tobacco tax enforcement using new stamp indicia (Sec. 943). We also appropriated \$3M to State Police for enhanced enforcement. The administration took the money but vetoed all boilerplate. We have worked on this issue ever since then and currently Treasury is analyzing a RFI that will lead to a new stamp RFP in the next few weeks.

6. It should be noted that the heat-transfer cigarette stamp we are currently using is no longer being manufactured and so SOMETHING must be done.

7. The tax indicia system allows us to enhance our enforcement of Michigan tax law and aids us in diligent enforcement arguments by verifying the entire distribution system as well as identifying taxes paid. Any cigarette pack with missing distribution lineage indicates illegitimacy of the product and identifies at what point the problem occurred.